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SUBJECT: PANAMA: ECONOMIC TRENDS AND LOOMING CHALLENGES

¶1. (U) This message is sensitive but unclassified; please protect accordingly.

¶2. (SBU) Introduction: Hoping to capitalize early on its campaign promises (anti-corruption, transparency, fiscal responsibility and economic growth), current popularity (70 percent), and control of the legislature, the Torrijos Administration is poised to press ahead with a very ambitious economic agenda. This agenda includes fiscal reform, fixing the social security program, negotiation and ratification of an FTA with the U.S., and teeing up a political referendum on Canal expansion before 2005 is over. While the agenda's economic imperative is clear to most of Panama, its execution represents a negative agenda for many entrenched interests and will be a heavy lift politically. 2005 promises to be a defining year for the Torrijos Administration and a test of its willingness and Panama's readiness to move more firmly out of the corruption, clientelism, and paternalism matrix. This cable provides Panama watchers a snapshot of these and other economic developments. End introduction.

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The Fiscal Reform and Social Security Packages  
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¶3. (SBU) Minister of Economy and Finance (MEF) Ricaurte Vasquez is scheduled to unveil an over-due package of fiscal reform proposals this week. However, it is not clear whether the proposals to fix the social security system are ready for prime time. In terms of timing, we expect the fiscal reforms to be discussed with business groups this week and then pushed through in an extraordinary legislative session sometime in January. Reform of the actuarially bankrupt Social Security System (Spanish abbreviation CSS) will probably be taken up by the legislature during the February/March time-frame to seek passage before the bulk of university students return to regular classes mid-March. (Note: the GoP clearly expects heated demonstrations and possible civil disturbances by students and labor groups. End Note.)

¶4. (SBU) Regarding fiscal reform the message is clear: those who can afford to pay (Panama's business class) are going to be asked to pay, and the MEF will also announce a series of measures to improve and simplify tax administration. In talking with Panama's business elite it is evident that many of them are not enamored with the prospect of increased taxes (or being put in the position of having to pay taxes) as they feel not enough is being done to address a bloated and inefficient public sector. Despite this there seems to be an understanding that it's time to try and fix the system. As one senior official (and businessman) said "this is the price we have to pay for being in Panama" (read: to continue enjoying a low-crime, stable political and economic environment). Reforming the social security system (CSS) will be a tougher prospect as it affects Panama's working class; however, a broad consensus seems to be developing that the current situation is untenable. The GoP will likely manage this by picking the least offensive measures such as increasing the retirement ages for men and women and increasing the number of contributory years; rather, than reducing benefits or significantly increasing workers contributions. See para (9) for a further discussion of the program woes.

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Tightening the Budgetary Belt?  
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¶5. (SBU) Despite efforts to limit public spending by the Minister of Economy and Finance Ricaurte Vasquez since taking

office -- and primarily as a result of excesses of the previous Moscoso Administration -- the 2004 budget deficit is expected to reach 5.3 percent of GDP with the overall stock of public sector debt increasing to around 66 percent of GDP. Nevertheless, GDP grew an impressive 6 percent in 2004 primarily as a result of export oriented growth and a construction boom fueled by tax incentives (and most likely illicit sources of funds). Growth for 2005 is forecasted to be 5 percent. While the 2005 general budget passed last month was trumpeted as "austere," the GoP was cautious not to tighten too much (this would have slowed growth down and caused political heartburn. As Panama has no monetary policy, fiscal policy is the only major policy lever available). The approved 2005 budget of \$6.192 billion mirrors the 2004 budget of \$6.168 billion. A budget deficit of 3.5 percent is forecasted for 2005.

**16. (U)** While the GoP's penchant to keep taking on more debt is troubling (debt service represents \$1.417 billion or 22.9 percent of the 2005 budget), Panama's economic health is enviable when compared to most countries in the region. Two of the three sovereign credit rating agencies currently have Panama one notch below investment grade. These agencies are also carefully watching the measures Panama takes over the next few months which has implications for Canal expansion. Separately, citing well-known excesses of the previous two administrations, President Torrijos has also promised to publicize an account of discretionary funds usage every three months in order to reduce corruption and increase transparency.

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FTA: An Easy Ratification?  
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**17. (SBU)** Jerry Wilson, President of Panama's Legislative Assembly, commented to EmbOffs that once negotiated the FTA agreement "will pass." However, Minister of Trade and Industries Alejandro Ferrer has remarked several months past to EmbOffs that ratification of the FTA could be harder to obtain than reform of the Social Security System. (Comment. Hyperbole aside, Ferrer's statements may be a positioning tactic to emphasize to us that depending on the negotiations outcome (read: agriculture), ratification may not be a sure thing. However, Torrijos's PRD party holds a majority in Congress and President Torrijos and his team have consistently signaled their strong support for a FTA. End comment.) Separately, it is also clear, both from discussions with senior USG officials and what we are hearing at Post, that the GoP is seeking to set up rice as their exclusion-candidate -- citing the 60 thousand-plus jobs in the sector.

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Panama Canal Expansion  
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**18. (SBU)** The proposed Canal expansion project to construct a third-set of locks has an estimated price tag of \$4-6 billion and is expected to take 8-10 years to complete. However, the constitution requires a national referendum first be submitted to the Panamanian people for their approval. GOP officials have stated this referendum will most likely occur in late 2005 or early 2006, and not earlier, as originally touted. Actual timing of the referendum will likely depend on how quickly the Canal can mount an educational/public relations campaign aimed at garnering broad public approval and how much heat the Torrijos Administration takes on fiscal and social security reform. The GoP is very aware that political referendums have had a history of failure in Panama -- voters have used them to register general discontent irrespective of the issue's merits -- and will want to carefully manage the process and timing. (Comment: Interestingly, we hear from various sources that Canal personnel are still working from timelines that have the referendum taking place mid-2005. End Comment.)

**19. (SBU/NOFORN)** The expansion is expected to be financed through a combination of Canal revenues, new user fees, and bridge loans. Privately, we understand that the ACP is looking to levy a new "construction tax" (paid by the Canal's customers i.e., the world's shippers) that would take effect the day after the referendum is approved to fund a significant portion of the project. The Torrijos Administration is clearly very enamored with the project and see it as jobs-creation machine, a vehicle to consolidate

Panama's position as a premier maritime/logistical/entrepot venue, and solidifying their role in Panama's history (the vision thing).

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Anti-Corruption Efforts: Or a Case of Too Many Straw Tails ?  
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¶10. (SBU) Staying true to Torrijos's campaign promise of "zero corruption," Vice Minister of Finance Rolando Mirones submitted a formal request to the Public Ministry that former MEF Norberto Delgado be investigated for "illicit enrichment" on Monday, November 1. Prohibited from speaking freely about the evidence the current GOP has obtained, Mirones stated that Delgado cannot justify his current assets. La Prensa, Panama's leading newspaper, cited marked increases in Delgado's net worth on his sworn declarations of wealth during the last five years. Mirones further commented that this action was a direct message for former GOP authorities that the Torrijos Administration will file complaints when there is evidence. (Note. Delgado also contacted Embassy to document "his side" of the story. Details to be provided via septel. End note.)

¶11. (SBU) Panama's anti-corruption prosecutor issued an arrest order for Bolivar Pariente, former General Manager of Panama's National Bank (BNP) for charges of approving a loan in violation of BNP policies. Under Pariente's leadership, the BNP granted a loan to a corporation to build the Prados del Este housing development which flooded in September 2004. According to the charges, BNP granted credit facilities for the project in violation of the law that established BNP and the BNP ethics manual. Total loss is estimated to be \$12 million. Pariente remains outside Panama. (Note: Pariente was briefly in the United States but then departed. Embassy has revoked Pariente's visa, as a "flight risk," to impede his entry into the U.S. should he try to return. End note.)

¶12. (SBU) While these and other efforts are salutary, it remains to be seen how true Torrijos will be to the campaign promise of zero corruption. Many in Panama's elite (and elsewhere) doubt that any big fish will be prosecuted or that Torrijos will go after his own. As one person said, there are too many people with "straw tails" in Panama (read: light mine, and I light yours). This is the one area where Torrijos can establish and maintain credibility with Panama's voters even if they disagree with him on other things such as economic reforms. The polls clearly show that corruption and employment are the major concerns of average Panamanians. Who Torrijos selects as Attorney General (a critical ten-year appointment rumored for this week) will be telling.

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Fixing Social Security  
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¶13. (U) Press and other reports indicate that the Panamanian Social Security System (Spanish abbreviation CSS) will exhaust its resources in 2011 if reforms are not taken. Plagued by increasing life expectancies and static contribution rates and rules, the CSS maintains a large gap between the amount paid in and the amount paid out. Created in 1941 when the average life expectancy was 60 years, the CSS set retirement ages (the age at which the CSS would pay benefits) at 60 years for men and 55 years for women. Contrastly, Panama's average life expectancy in 2004 is 74 years but its retirement ages have changed little: 62 years for men and 57 years for women. Additionally, the rate of contributors per retiree (the number of contributors paying into the system for every retiree) has drastically declined from 58 contributors in 1941 to 5 contributors in 2004. Currently, Panamanians are only required to contribute to the CSS for 15 years. For example, a woman retiring after 15 years of contributions at 57 years with a life expectancy of 72 years is expected to receive over 4 times what she put into the system. Factoring in inflation adjustments as well, it is no surprise the CSS is losing approximately \$600 thousand per day. While a dialogue continues between the CSS, employer, and labor groups over how to best reform the CSS, no consensus has been reached. (Note: The CSS provides pensions, medical services, and workers' compensation to over 60 percent of Panama's three million population. The Disability, Old Age, and Death (IVM) program component provides pensions to Panamanians; for many, this is their only source of retirement income. End note.)

¶14. (U) Recent press reports have highlighted Minister of Economy and Finance (MEF) Ricaurte Vasquez's comments that the financial crisis of the Caja de Seguro Social (CSS),

Panama's Social Security System, could present an obstacle for the expansion of the Panama Canal. According to Vasquez, international financial institutions, from whom Panama would borrow to finance the Canal's expansion, fear Canal monies would be used to finance CSS obligations. This could result in higher interest rates from the lending international markets.

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Container Traffic  
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¶15. (SBU) Manzanillo International Terminal (MIT), the largest container port in Latin America, recently announced a 30 percent growth in TEU movements (Twenty foot equivalent units; the industry standard to measure containers) over last year. MIT moved 1.9 million TEUs in 2003, an increase of 800,000 units from the 1.1 million TEUs in 2002. This growth can be attributed to economic recovery in Latin America and increased commercial trade with China. (Comment: While Panama sees significant transshipments through ports such as MIT, Evergreen's Colon Container Terminal (Taiwanese-owned) and Hutchinson-Whampoa's Panama Ports Company (Chinese owned), the volume of containers (carrying local export) sent to the U.S. is quite small, probably around 15,000 TEUs. The Panama Canal Authority (ACP) cites that during FY 2004, 5,947,092 containers passed through the Canal. Of these, 1,696,868 containers were destined for the East Coast of the United States and 58,200 were destined for the West Coast.

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Panama Canal (ACP) Breaks the Billion Dollar Mark  
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¶16. (U) The Panama Canal Authority (ACP) earned a record \$1.06 billion for the fiscal year ending September 30, 2004, with \$757.7 million collected from transit tolls. (Note: The ACP maintains the U.S. fiscal accounting year. \$923 million was earned in 2003. End note.) Revenues passed to the central government from Canal operations (dividends, tonnage fees, and services) came to around \$332 million, up from \$294 million the previous fiscal year. Such revenues will come to around \$384 million during FY 2005. Gross cargo throughput was approximately 267 million tons, a 10 percent increase over 2003. The number of "Panamax" vessels (currently the largest ships which cross the Canal) transiting the canal increased 12.5 percent to 5,329 and total transits grew by 6.7 percent to 14,035. The ACP reported only ten accidents during this year, the least number reported in the last 81 years. According to the ACP, the principal route utilizing the Canal was from Asia to the East Coast of the United States and the Gulf of Mexico. Approximately 66 percent of the cargo transiting the Canal is going to or from the United States.

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ACP: A Strict Question of Supply and Demand or We Did It  
Because We Could  
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¶17. (SBU/NOFORN) Taking advantage of its market position and the growth in containerization that is driving global maritime trade, the Panama Canal Authority (ACP) is proposing to modify its toll system and rules of measurement for container ships in order to establish a toll structure based on a charge per TEU (twenty-foot equivalent unit) to account for on-deck containers (of which presently only 8.78 percent is covered). For a full container vessel the proposal establishes a \$42 per TEU toll beginning May 1, 2005, \$49 per TEU toll beginning January 1, 2006 and \$54 per TEU toll beginning January 1, 2007. A senior shipping industry contact said that the net effect of the change will be a 65 percent increase in the total transit cost per Panamax sized vessel from \$170,000 to \$280,000. The ACP for its part feels this is "back pay." Despite some grousing, shippers will pass the costs onto their customers (the Walmart and Home Depots of the world), and recognize the Canal is still the best game in town (the U.S. intermodal system Long Beach/LA is reportedly operating at capacity and the Suez Canal is costlier). The ACP also knows this and expects to add in excess of \$40 million to its bottom line just during the first year the change goes into effect.

18. (SBU) On November 5, the GOP formally announced its entrance to the now G-4 (Group of Four), formally the G-3 consisting of Colombia, Venezuela, and Mexico. GoP officials have stated that Panama's G-4 accession is to promote Panama's economic, political, and social integration with those countries. MFA Senior Advisor Nils Castro commented to EmbOffs, during a November 24 meeting, the G4 represented a consolidation of Panamanian economic integration with the G3 markets as well as a vehicle to improve Panama's attractiveness as a hub into those markets given the small size of Panama's internal market. Castro noted that accession to the existing current trade agreement between those countries has to be worked out, but added the current agreement includes agricultural safeguards which should make things easy for Panama. Castro also added that the G-4 agreement could eventually further Panama's penetration into Ecuador and Peru where Panama sees real potential. Panama's commercial exchange with Venezuela is small. Principal exports will be consumer or manufactured products. While GOP officials have been reticent to provide specifics in public venues on how Panama will accede to G-4, Castro commented that negotiations would begin soon after the closure of the U.S.-Panama FTA. According to the G-3's original agreement signed by the three original members on June 13, 1994, tariffs would be reduced to zero by January 2005.

A Victory for Environmentalists

19. (U) Former-President Moscoso authorized the construction of a paved highway through the Volcan Baru national park reserve in 2001. It was ostensibly to be used to connect two previously separated villages for commercial reasons, and to support eco-tourism for the park. In reality, the road would have simplified access to several of Moscoso's coffee farms in the area. National and international opposition to the road was extremely intense, and construction stalled due to protests, legal actions, and propitiously bad weather. During the last week of October, President Torrijos formally struck down a previous decree of then-President Moscoso that had allowed the construction of the so-called "Camino Ecologico." With this action, the proposed road construction is permanently halted.

On the Horizon

20. (SBU) The GOP is continuing discussions with Colombia for electricity and gas pipelines to flow through Panama to connect Central America. It is estimated that Central America will require approximately 5,840 additional MW in 2015. In April 2003, Panama and Colombia signed a MOU to perform feasibility studies of an Electric and Gas Interconnection between Panama and Colombia. On November 1, 2004, Panama signed an MOU with Colombia to conduct a feasibility study for a gas pipeline interconnection from Colombia to Panama. GOP officials are continuing government-to-government discussions as well as beginning discussions with the private sector as the cost of the projects would be borne totally by the private sector. In a November 24 meeting with EmbOffs, MFA Official Nils Castro stated Panama preferred a water connection for both projects because it would provide a lower security risk, reduce illegal immigration possibilities, and maintain the Darien as a natural barrier against infectious animal diseases (i.e., hoof and mouth, screwworm, etc). According to the GoP, the pipeline would most likely go across the Atlantic Ocean, connecting Cartegena, Colombia, with Colon, Panama. (Comment: While interesting so far much of this is just talk. The GoP recently asked Post for possible technical assistance (through USTDA) on the gas project. End Comment. WATT